COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, NOVEMBER 8, 2002

APPLICATION OF

APPALACHIAN POWER COMPANY
d/b/a AMERICAN ELECTRIC POWER

CASE NO. PUE-2002-00378

To revise its fuel factor
pursuant to Va. Code § 56-249.6

ORDER ESTABLISHING 2003 FUEL FACTOR

On July 1, 2002, Appalachian Power Company d/b/a American Electric Power ("AEP," "Appalachian" or the "Company") filed with the State Corporation Commission ("Commission") its application, written testimony, and exhibits requesting an increase in its fuel factor from 1.310¢ per kWh to 1.488¢ per kWh effective with bills rendered on and after January 1, 2003, which results in an increase in annual fuel revenues of approximately $28.1 million.

By Order dated July 16, 2002, the Commission established a procedural schedule, required notice of the application, and set a public hearing date for this matter. In the July 16, 2002, Order, the Commission directed its Staff to file testimony and provided an opportunity for any person desiring to participate in the hearing to do so. The Old Dominion Committee for Fair Utility Rates (the "Committee"), the Town of Wytheville and the

Virginia Municipal League/Virginia Association of Counties APCo Steering Committee ("Town of Wytheville & VML/VACo APCo Steering Committee"), and the Division of Consumer Counsel, Office of the Attorney General ("Consumer Counsel") filed notices of participation as respondents in the case.

On September 16, 2002, Staff filed its testimony. Staff recommended that Appalachian's in-period factor should be 1.401¢ per kWh and correction factor should be 0.023¢ per kWh which incorporated Staff's proposed disallowance of approximately $10 million in replacement power costs (i) allocated to Appalachian through the AEP Interconnection Agreement, and (ii) necessitated by the Nuclear Regulatory Commission ("NRC")-prompted shut-down of the Donald C. Cook nuclear generating units ("Cook") operated by Appalachian's affiliate, Indiana Michigan Power Company ("I&M"), which outage extended from 1997 to 2000. On September 19, 2002, the Company filed its rebuttal testimony.

The hearing to receive evidence on the fuel factor issues was convened on September 23, 2002. Appearances were made by counsel for the Staff, Appalachian, the Committee, Town of Wytheville & VML/VACo APCo Steering Committee, and Consumer Counsel. Testimony was received from Mr. Barry L. Thomas, Mr. Stephen D. Baker, Mr. Oliver J. Sever, and Mr. Thomas L. Stephens for Appalachian; and Mr. Jarilaos Stavrou, Dr. Timothy Lough, and Mr. Michael W. Martin for the Staff.

Company witness Thomas testified that consistent with the Commission's longstanding treatment of costs related to the AEP system pool ("Pool"), the Commission should approve the Company's proposed fuel factor and reject Staff's proposed disallowance for replacement fuel costs resulting from the Cook outage.

Company witness Baker testified concerning Appalachian's long-term coal supply agreements, coal purchasing strategy, and responses to the coal market conditions. Mr. Baker supported the Company's fuel forecast as being reasonable for the purpose of setting fuel cost factors.

Company witness Sever testified concerning Appalachian's forecast of total net energy cost for the June through December of 2002 period, as well as the forecast period of calendar year 2003. Mr. Sever's rebuttal testimony opposed Staff's recommendation of disallowance of the Cook replacement fuel costs and clarified the Company's position that complex regulatory settlements related to the Cook outage were reached in the Michigan and Indiana jurisdictions.

Company witness Stephens testified regarding Appalachian's actual monthly fuel costs and fuel costs over- and under-recovery calculations, the development of the Company's proposed fuel factor, and revenue and customer impacts associated with implementation of the proposed fuel factor. In addition, Mr.

Stephens' testimony addressed the Company's currently approved definitional framework of fuel expenses to accommodate proposed changes in the purchased power component of the Company's fuel expense going forward. Finally, Mr. Stephens' testimony updated the Company's projections for the months of May 2002, through August 2002, to reflect an updated estimated under-recovery position at the end of 2002, of $9,817,137. This results in a total fuel factor of 1.463¢ per kWh.

Staff Witness Martin testified concerning Staff's recommendation of year 2003 fuel factor of 1.424¢ per kWh for Appalachian, which is composed of an in-period factor of 1.401¢ per kWh, and a correction factor of 0.023¢ per kWh.

Staff Witness Stavrou testified concerning his evaluation of the reasonableness of forecasted energy sales and fuel prices and the appropriateness of the fuel cost projections with respect to the Commission's standards. Mr. Stavrou's testimony concluded that the Staff did not oppose the Company's estimates for the purpose of developing a fuel factor, but he added that his conclusion did not constitute a finding of prudency by the Staff.

Staff witness Lough testified concerning Staff's recommendation of a partial disallowance of the net replacement power costs incurred as a result of the three-year outage at the Cook plant, from 1997 to 2000. During Mr. Lough's testimony,

Company counsel Michael Quinan proffered a motion to strike Mr. Lough's testimony. The Commission took Mr. Quinan's motion under advisement and deferred making a ruling on the motion to strike. At the conclusion of the hearing, parties requested the presentation of briefs of legal issues before the Commission.

On October 18, 2002, the participants filed their respective post-hearing briefs. The Committee argued in its brief in support of a disallowance of all or a portion of the Cook replacement power costs. The Committee maintained that the Company failed to make its required showings, pursuant to Va. Code § 56-249.6, regarding the costs of replacement power used during the extended outage of the Cook nuclear units from September 1997 through December 2000. In addition, the Committee argued that Appalachian failed to demonstrate to the Commission that it made every reasonable effort to minimize its fuel costs during the outage and the Company has failed to demonstrate that none of its decisions resulted in unreasonable fuel costs during that outage.

The Town of Wytheville & VML/VACo APCo Steering Committee argued in its brief that the facts of this case supported a reasonable conclusion that the increased fuel costs associated with and arising from the Cook nuclear plant outage need not and should not be recognized in the Company's fuel factor. In addition, the Town of Wytheville & VML/VACo APCo Steering

Committee argued that the Commission is not disabled from disallowance of replacement fuel costs as it finds necessary to protect Appalachian's Virginia retail customers from absorbing such costs.

Consumer Counsel argued in its brief that, under Va. Code § 56-235.3, the Company has the burden of proof to show that the proposed change in its fuel costs are just and reasonable. Consumer Counsel maintained that Appalachian failed to show at hearing that the proposed revision to its fuel factor is just and reasonable and the Company did not make every reasonable effort to minimize its fuel costs during the past period. Therefore, Consumer Counsel stated that the Commission was required to disallow recovery of the portion of the fuel costs applied for by the Company associated with the Cook plant replacement power. Finally, Consumer Counsel argued that the Commission has the authority under Virginia law to determine whether Appalachian has shown that it has reasonably incurred its fuel costs, and under the facts in this case, the Commission's authority to make this determination is not subject to federal preemption.

The Company argued in its brief that the Commission may not properly deny the Company's recovery of its replacement power fuel costs associated with the Cook outage. First, the Company maintained that the Staff has provided the Commission with an

insufficient evidentiary foundation for its recommendation that the Company should be denied its replacement power fuel costs. Second, the Company argued that in order for the Commission to disallow their replacement power fuel costs it would need to assert jurisdiction over I&M to inquire into the prudency of I&M's actions as they relate to the Cook outage, and such jurisdiction cannot be maintained. Third, the Company argued that Virginia's fuel factor statute, Va. Code § 56-249.6, does not provide the Commission with any basis to deny Appalachian recovery of replacement power fuel costs under the circumstances of this case. Fourth, the Company disagreed with the Staff's theory of "concomitant entrustment," based upon the interdependent nature of the AEP Pool, and maintains that Staff's theory does not provide a lawful or appropriate basis to deny recovery of the replacement power fuel costs. Finally, the Company maintained that the Commission is preempted by federal law from disallowing replacement power fuel costs where Appalachian incurred those costs through the AEP Interconnection Agreement approved by the Federal Energy Regulatory Commission ("FERC").

The Staff argued in its brief that the FERC's approval of the AEP operating companies' Interconnection Agreement does not mean that the FERC has thus pre-approved all costs flowing through the interconnection –- only the methodology for their

allocation. The Staff maintained that the Commission can disallow replacement power costs proposed to be paid by Appalachian's Virginia jurisdictional ratepayers to the extent that the Company has failed to make every reasonable effort to minimize fuel costs, as required by law under the provisions of Va. Code § 56-249.6. Furthermore, the Staff argued that through Appalachian's inaction, and failure to pursue remedies available to it under and related to the Interconnection Agreement, the Company failed to satisfy its obligations to its Virginia ratepayer under § 56-249.6 to minimize fuel costs. Therefore, the Staff argued that, as a matter of fact and law, the Commission can and should disallow Appalachian's replacement power costs, in whole or in part. Finally, the Staff maintained that the evidentiary record of the case supports the disallowance recommended –- the Company's motion to strike the testimony of Staff witness Lough, notwithstanding.

NOW THE COMMISSION, upon consideration of the pleadings, the record, and the applicable law, is of the opinion and finds as follows. We deny Appalachian's motion to strike the testimony of Staff witness Lough. We approve Appalachian's inclusion in its proposed fuel factor of net replacement power costs associated with the Cook outage. Accordingly, we adopt Appalachian's requested total fuel factor of 1.463¢ per kWh.

The standard that we must apply in this proceeding is set forth in § 56-249.6 of the Code, which provides, among other things, the following:

> The Commission shall disallow recovery of any fuel costs that it finds without just cause to be the result of failure of the utility to make every reasonable effort to minimize fuel costs or any decision of the utility resulting in unreasonable fuel costs, giving due regard to reliability of service and the need to maintain reliable sources of supply, economical generation mix, generating experience of comparable facilities, and minimization of the total cost of providing service.

Based on the record developed in this proceeding, we do not find that Appalachian's proposed net replacement power costs are, without just cause, the result of the failure of Appalachian to make every reasonable effort to minimize fuel costs or are the result of any decision of Appalachian resulting in unreasonable rates. As a result of such finding, we do not reach the issue of federal preemption addressed in the participants' briefs.

The Company has the initial burden under § 56-249.6 of the Code. Appalachian must show how its efforts minimized, and resulted in reasonable, fuel costs. Appalachian has met its initial burden in this case. For example, the Company presented evidence that its Virginia jurisdictional customers historically have received the benefit of low cost electricity in part because of the Pool, that the Pool enables Appalachian's energy

requirements to be met economically, that Appalachian benefited from membership in the Pool during the Cook outage, and that its cost of replacement energy from the Pool in this case was lower than its cost would have been for replacement energy outside the Pool. The Company does not, as part of its initial burden, have to rebut every conceivable alternative that it may have taken.

The Staff and the respondents seek denial of part or all of net replacement fuel costs resulting from the Cook outage. With Appalachian having met its initial burden, these participants must present a minimum threshold of evidence that could support a disallowance. This has not occurred. We find that there is insufficient evidence in the record upon which to deny recovery of part or all of the net replacement power costs under § 56-249.6 of the Code.

First, regarding any alleged imprudence that resulted in the Cook outage, the evidence presented in this proceeding falls short of establishing the imprudence of any action or inaction that may have caused such outage. Next, the respondents and the Staff identify actions that Appalachian could have taken, but did not, in an effort to minimize fuel costs subsequent to the Cook outage.[1] There is, however, essentially no evidence in this

[1] For example, the participants assert that Appalachian could have, among other things: (1) made independent arrangements for power outside of the Pool; (2) issued a request for proposal to determine if a less expensive source was available; (3) sought modification of its Interconnection Agreement; (4) instituted action at FERC to protect itself or its customers

case beyond the listing of actions that could have been taken by Appalachian. We also note that the participants, in arguing that the Company should have taken actions such as purchasing outside of the Pool or issuing a request for proposal to determine if less expensive power was available, did not even suggest what the savings might have been. Once the Company has met its initial burden, as Appalachian did here, there must be more than simple allegations or a list of other possible actions the Company might have taken. The alternatives must be developed and there must be evidence before we can consider the actions proffered by those who seek to disallow a part of the Company's fuel expense.

Accordingly, IT IS HEREBY ORDERED THAT:

(1) Appalachian's motion to strike the testimony of Staff witness Lough is denied.

(2) Appalachian's total fuel factor, effective for usage on and after January 1, 2003, shall be 1.463¢ per kWh.

(3) This matter is continued generally.

---

from increased fuel costs resulting from the Cook outage; (5) negotiated with its parent company or sister AEP utilities; (6) attempted to shorten the duration of the outage; (7) asserted a claim against the owner of Cook; or (8) withheld payments from the Pool. Specific assertions that Appalachian did not make reasonable efforts subsequent to the outage to minimize fuel costs were raised for the first time at the hearing and were repeated in the briefs of the Staff and the respondents.